

# **Iowa Schools Employee Benefits Association**

Financial Statements

06.30.2004

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# McGladrey & Pullen

Certified Public Accountants

## Independent Auditor's Report

The Board of Directors  
Iowa Schools Employee Benefits Association  
Des Moines, Iowa

We have audited the accompanying basic financial statements of Iowa Schools Employee Benefits Association (ISEBA), as of and for the year then ended June 30, 2004 as listed in the table of contents. These financial statements are the responsibility of ISEBA's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of ISEBA as of June 30, 2004, and the changes in its financial position and of its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated May 18, 2005, on our consideration of ISEBA's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis on pages 2 and 3 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

*McGladrey & Pullen, LLP*

Davenport, Iowa  
May 18, 2005

## Iowa Schools Employee Benefits Association

### Management's Discussion and Analysis For Fiscal Year Ended June 30, 2004

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This narrative overview and analysis of the financial activities of the Iowa Schools Employee Benefits Association is presented by ISEBA's management and is for the fiscal year ended June 30, 2004. Readers are encouraged to consider the information presented here in conjunction with ISEBA's financial statements, which follow this overview.

#### Financial Highlights

- ISEBA's total net assets for fiscal year June 30, 2004 increased \$3,440,288 over June 30, 2003. June 30, 2004 net assets totaled \$(794,749). June 30, 2003 net assets were \$(4,235,037).

#### Using this Annual Report

This Discussion and Analysis is intended to serve as an introduction to ISEBA's basic financial statements. ISEBA's basic financial statements consist of a series of financial statements. The statement of net assets, the statement of revenues, expenses and changes in net assets and the statement of cash flows provide information about the activities of ISEBA and present a longer-term view of ISEBA's finances. These basic financial statements also include the notes to the basic financial statements and explain some of the information in the statements and provide more detail.

#### Overview of the Financial Statements

Statement of net assets: The statement of net assets presents the assets, liabilities and net assets of ISEBA as of the end of the fiscal year. The statement of net assets is a point-in-time financial statement. The purpose of this statement is to present a fiscal snapshot of ISEBA to the readers of the financial statements. The statement of net assets includes year-end information concerning current assets that can reasonably expect to be collected or consumed within a year or less. Over time, readers of the financial statements are able to determine ISEBA's financial position by analyzing the increases and decreases in net assets. This statement is also a good source for readers to determine how much ISEBA owes to outside vendors and creditors. The statement also presents the available assets that can be used to satisfy those liabilities.

All of ISEBA's net assets are unrestricted and can be used to meet ISEBA's obligations.

	2004	2003
Current assets	\$ 6,787,172	\$ 11,557,925
Noncurrent assets, premium assessment	5,058,238	-
<b>Total assets</b>	<b>\$ 11,845,410</b>	<b>\$ 11,557,925</b>
Current liabilities:		
Unpaid claims	\$ 11,550,203	\$ 14,509,872
Advanced premiums	637,794	784,910
Accounts payable	452,162	498,180
<b>Total current liabilities</b>	<b>12,640,159</b>	<b>15,792,962</b>
Net assets, unrestricted	<b>(794,749)</b>	<b>(4,235,037)</b>
<b>Total liabilities and net assets</b>	<b>\$ 11,845,410</b>	<b>\$ 11,557,925</b>

## Iowa Schools Employee Benefits Association

### Management's Discussion and Analysis For Fiscal Year Ended June 30, 2004

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Statement of revenues, expenses and changes in net assets: Changes in total net assets, as presented on the statement of net assets, are based on the activity presented in the statement of revenue, expenses and changes in net assets. The purpose of the statement is to present the revenue received by ISEBA, both operating and nonoperating, and the expenses paid by ISEBA, both operating and nonoperating, and any other revenues, expenses, gains and losses received or spent by ISEBA.

Operating revenues are received as commissions and premiums, net of reinsurance premiums and totaled \$108,932,506 of the \$108,988,709 total revenue. Operating expenses totaled \$105,548,421 and were expended for claims and administration. Nonoperating revenues are revenues received on investments.

	2004	2003
Operating revenue	\$ 108,932,506	\$ 120,137,880
Nonoperating revenue, investment	56,203	95,589
<b>Total revenue</b>	<b>108,988,709</b>	<b>120,233,469</b>
Operating expenses	105,548,421	130,567,910
<b>Change in net assets</b>	<b>3,440,288</b>	<b>(10,334,441)</b>
Net assets, beginning	(4,235,037)	6,099,404
Net assets, ending	\$ (794,749)	\$ (4,235,037)

Statement of cash flows: The final statement included in ISEBA's basic financial statements is the statement of cash flows. The statement of cash flows is an important tool in helping the users to assess an entity's ability to generate future net cash flows, its ability to meet its obligations as they come due, and its need for external financing. The statement of cash flows presents information related to cash inflows and outflows, summarized by operating and investment activities.

	2004	2003
Cash provided by (used in):		
Operating activities	\$ (6,264,734)	\$ (8,933,602)
Investing activities	56,203	95,589
<b>Net decrease in cash</b>	<b>(6,208,531)</b>	<b>(8,838,013)</b>
Cash, beginning of year	10,236,646	19,074,659
Cash, end of year	\$ 4,028,115	\$ 10,236,646

### Economic Factors

- Health care inflation has been increasing at double-digit pace annually. Combined with increases in utilization by plan participants has resulted in higher than projected expenditures.
- ISEBA's cost structure during the fiscal year was negatively impacted by having a high proportion of fixed administration expenses and a significant loss in the number of participants.

### Contacting ISEBA's Financial Management

This financial report is designed to provide a general overview of ISEBA's finances, and to demonstrate ISEBA's accountability for the resources it receives. If you have questions about this report or need additional financial information, please contact the Iowa Schools Employee Benefits Association, 700 Second Avenue, Des Moines, Iowa 50309.

Iowa Schools Employee Benefits Association

Statement of Net Assets

June 30, 2004

**Assets**

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Current assets, cash and cash equivalents (Note 2)	<u>\$ 4,028,115</u>
Receivables:	
Premiums receivable	1,173,722
Reinsurance recoverable (Note 4)	505,335
Premium assessment	<u>1,080,000</u>
<b>Total current receivables</b>	<u>2,759,057</u>
 <b>Total current assets</b>	 <u>6,787,172</u>
 Noncurrent assets, premium assessment of \$6,138,238 net of current portion	 <u>5,058,238</u>
 <b>Total assets</b>	 <u><u>\$ 11,845,410</u></u>

**Liabilities and Net Deficit**

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Current liabilities:	
Unpaid claims (Note 5)	\$ 11,550,203
Advanced premiums	637,794
Accounts payable	<u>452,162</u>
<b>Total current liabilities</b>	<u>12,640,159</u>
 Net deficit, unrestricted	 <u>(794,749)</u>
 <b>Total liabilities and net deficit</b>	 <u><u>\$ 11,845,410</u></u>

See Notes to Basic Financial Statements.

Iowa Schools Employee Benefits Association

Statement of Revenues, Expenses and Changes in Net Assets (Deficit)  
Year Ended June 30, 2004

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Operating Revenues:	
Premiums written and earned	\$ 106,228,195
Less reinsurance premiums	<u>3,577,794</u>
<b>Net premiums written and earned</b>	102,650,401
Commission income	143,867
Premium assessments	<u>6,138,238</u>
<b>Net operating revenues</b>	<u>108,932,506</u>
 Operating Expenses:	
Claims expense (Note 5)	99,373,715
Third party administration, marketing and other service fee (Note 3)	5,987,763
General and administrative	<u>186,943</u>
<b>Total operating expenses</b>	<u>105,548,421</u>
 <b>Operating income</b>	3,384,085
 Nonoperating Revenue, interest income	<u>56,203</u>
 <b>Increase in net assets</b>	3,440,288
 Net Assets (Deficit), beginning of year	<u>(4,235,037)</u>
Net Assets (Deficit), end of year	<u><u>\$ (794,749)</u></u>

See Notes to Basic Financial Statements.

Iowa Schools Employee Benefits Association

Statement of Cash Flows  
Year Ended June 30, 2004

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Cash Flows From Operating Activities:	
Cash receipts from premiums	\$ 102,621,682
Cash receipts from commissions	143,867
Cash payments for claims expense	(102,807,719)
Cash payments for administration and other	<u>(6,222,564)</u>
<b>Net cash used in operating activities</b>	<u><b>(6,264,734)</b></u>
 Cash Flows From Investing Activities, interest received	 <u>56,203</u>
 <b>Decrease in cash and cash equivalents</b>	 <b>(6,208,531)</b>
 Cash and Cash Equivalents, beginning of year	 <u>10,236,646</u>
Cash and Cash Equivalents, end of year	<u><u>\$ 4,028,115</u></u>
 Reconciliation of Operating Income to Net Cash Flows From Operating Activities:	
Operating income	\$ 3,384,085
Changes in assets and liabilities:	
Receivables	(6,496,016)
Unpaid claims	(2,959,669)
Advances premiums	(147,116)
Accounts payable	<u>(46,018)</u>
<b>Net cash used in operating activities</b>	<u><u>\$ (6,264,734)</u></u>

See Notes to Basic Financial Statements.



## Iowa Schools Employee Benefits Association

### Notes to Basic Financial Statements

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#### Note 1. Nature of Business and Significant Accounting Policies

##### Nature of business:

Iowa Schools Employee Benefits Association (ISEBA) operates as a partially self-insured risk pool. ISEBA was formed July 1, 1999 under Chapter 28E of the Code of Iowa and provides insurance coverage to approximately 15,000 employees of 170 Iowa school districts and area education agencies. ISEBA self-insures for medical, prescription drug, vision and dental coverage on an occurrence basis, subject to a reinsurance policy.

##### Significant accounting policies:

The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America as they apply to governmental entities. Pursuant to the Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Funds that Use Proprietary Fund Accounting*, ISEBA has elected not to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board issued after November 30, 1989.

Measurement focus and basis of accounting: The financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

Unpaid claims: Unpaid claims is a liability for reported and unreported incurred claims and was estimated based upon prior claims experience and subsequent claim lag reports. Changes in estimates are reflected in claims expense in the statement of revenues, expenses and changes in net assets (deficit).

Use of estimates: The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the recorded amounts of assets and liabilities and disclosure of contingent assets and liabilities as the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Premium assessment: ISEBA assessed all participants for the run-out liability and financial shortages from the self-funded program.

Operating revenues and expenses: Operating revenues result from exchange transactions associated with the principle activity of ISEBA, the providing of insurance coverage. Operating expenses are defined as expenses directly related to, or incurred in support of, the providing of insurance coverage to participating members. Interest income is classified as nonoperating revenue.

Income taxes: ISEBA is tax-exempt because it is an instrumentality of the state of Iowa, formed under Chapter 28E of the Iowa Code.

Investments: ISEBA invests in the Iowa Schools Joint Investment Trust regulated by the Iowa Association of School Boards. The fair value of the position in the investment pool is the same as the value of pooled shares.

## Iowa Schools Employee Benefits Association

### Notes to Basic Financial Statements

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#### Note 2. Deposits and Investments

ISEBA's deposits as of June 30, 2004, were entirely covered by federal depository insurance, or collateralized by a multiple financial institution collateral pool in accordance with Chapter 12C, Code of Iowa. This Chapter provides for additional assessments against the depositories to ensure there will be no loss of public funds. As of June 30, 2004, the carrying amount of ISEBA's cash deposits was \$4,026,744 and the bank balance was \$4,028,769.

ISEBA had \$1,371 invested in the Iowa Schools Joint Investment Trust as of June 30, 2004, pursuant to Rule 2a-7 under the Investment Company Act of 1940 and is not subject to risk categorization.

#### Note 3. Related Party Transactions

ISEBA has a support services agreement with the Iowa Association of School Boards, an affiliate. The agreement is subject to termination by either party upon six months written notice. During the year ended June 30, 2004, management fees of \$240,000 were incurred.

ISEBA also has a support services agreement with the Iowa State Education Association, an affiliate. The agreement is subject to termination by either party upon six months written notice. During the year ended June 30, 2004, management fees of \$240,000 were incurred.

ISEBA has contracted with Morneau Sobeco, Ltd. (Morneau) to provide services to ISEBA. The agreement calls for an annual fixed fee to be paid to Morneau in the amount of \$804,000 per annum, payable in equal monthly installments for consulting and service fees. The agreement also has variable charges per participant for administrative fees on billing and premium reconciliation transaction services and other miscellaneous charges. During the year ended June 30, 2004, variable fees totaling \$1,320,136 were incurred.

#### Note 4. Reinsurance

ISEBA has maintained a reinsurance policy for the year ended June 30, 2004 for which the specific limit of indemnity is limited to \$250,000, with an aggregate coverage of 125% of excepted claims. As of June 30, 2004, ISEBA has reinsurance recoverable for claims amounting to \$505,335. Reinsurance recoveries are reported as a deduction in claims expense. Reinsurance recoveries for the year ended June 30, 2004 were \$2,829,990.

#### Note 5. Unpaid Claim Liabilities

ISEBA establishes a liability for both reported and unreported insured events, which includes estimates of both future payments of losses and related claims expenses. The following represents changes in those aggregate liabilities for ISEBA during the year ended June 30, 2004 and 2003:

	2004	2003
Unpaid claims, beginning of year, net of reinsurance	\$ 14,478,872	\$ 13,805,488
Incurred claims related to current year, net of reinsurance	99,373,715	123,232,257
Claims paid related to current year, net of reinsurance	(102,807,719)	(122,558,873)
Unpaid claims, end of year, net of reinsurance of \$505,335 and \$31,000, respectively	<u>\$ 11,044,868</u>	<u>\$ 14,478,872</u>

## Iowa Schools Employee Benefits Association

### Notes to Basic Financial Statements

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#### **Note 6. Pending Pronouncements**

As of June 30, 2004, the Governmental Accounting Standards Board (GASB) had issued the following statements not yet implemented by ISEBA. The statements which might impact ISEBA are as follows:

Statement No. 40, *Deposit and Investment Risk Disclosures*, issued March 2003, will be effective for ISEBA beginning with its year ending June 30, 2005. This Statement establishes and modifies disclosure requirements related to investment risks related to credit risk, concentration of credit risk, interest rate risk and foreign currency risk. As an element of interest rate risk, this Statement requires certain disclosures of investments that have fair values that are highly sensitive to changes in interest rates. This Statement also establishes and modifies disclosure requirements for deposit risks.

Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, issued November 2003, will be effective for ISEBA beginning with its year ending June 30, 2006. This Statement requires governments to report the effects of capital asset impairment in their financial statements when it occurs and requires all governments to account for insurance recoveries in the same manner.

Statement No. 46, *Net Assets Restricted by Enabling Legislation*, an amendment of GASB Statement No. 34, will be effective for ISEBA beginning with its year ending June 30, 2006. The purpose of Statement No. 46 is to help governments determine when net assets have been restricted to a particular use by the passage of enabling legislation and to specify how those net assets should be reported in financial statements when there are changes in the circumstances surrounding such legislation.

ISEBA's management has not yet determined the effect these Statements will have on ISEBA's financial statements.

#### **Note 7. Subsequent Event**

Effective July 1, 2004 ISEBA is no longer self-funded.

Subsequent to year end ISEBA obtained a \$7,000,000 line of credit with a bank that expires June 30, 2005. Borrowings on the line of credit are only to be used to pay run out claims from fiscal year 2004. Outstanding borrowings on the line of credit totaled \$5,375,000 as of the date of the report.